

**PERU**

**STAGE THREE OF THE NATIONAL PROGRAM TO SUPPORT  
OPERATIONS OF THE COMPENSATION AND SOCIAL  
DEVELOPMENT FUND  
(FONCODES III)**

**(PE-0193)**

**LOAN PROPOSAL**

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## ABBREVIATIONS

CONAM	Consejo Nacional del Ambiente [National Environment Council]
CONAPAAA	Comisión de Pueblos Andinos, Amazónicos y Afroperuanos [Commission for Andean, Amazon and Afro-Peruvian Peoples]
CTI	Comisión de Transparencia, Ética y Probidad Institucional [Commission on Transparency, Ethics and Institutional Integrity]
EU	Executing unit
FONCODES	Fondo Nacional de Compensación y Desarrollo Social [National Compensation and Social Development Fund]
GDP	Gross domestic product
INADE	Instituto Nacional de Desarrollo [National Development Institute]
INDES	Instituto Interamericano para el Desarrollo Social [Inter-American Institute for Social Development]
INFES	Instituto Nacional de Infraestructura Educativa y Salud [National Institute for Education and Health Infrastructure]
INRENA	Instituto Nacional de Recursos Naturales [National Natural Resources Institute]
ISO	International Organization for Standardization
KfW	Kreditanstalt für Wiederaufbau
NGO	Nongovernmental organization
PCR	Programa de Caminos Rurales [rural roads program]
PRONAMACHCS	Programa Nacional de Manejo de Cuencas Hidrográficas y Consolidación de Suelos [National Watershed Management and Land Consolidation Program]
PRONASAR	Programa Nacional de Agua Potable Rural [National Rural Potable Water Program]
REDS	Racimos de desarrollo estratégico [strategic development clusters]
SMCS	Socioeconomic micro-corridors
TOR	Terms of reference
ZO	Zone office



## PERU

### IDB LOANS

APPROVED AS OF JULY 31, 2002

	<i>US\$Thousand</i>	<i>Percent</i>
<b>TOTAL APPROVED</b>	<b>5,814,193</b>	
DISBURSED	5,136,971	88.4%
UNDISBURSED BALANCE	677,222	11.6%
CANCELLATIONS	997,803	17.2%
PRINCIPAL COLLECTED	2,048,438	35.2%
<b>APPROVED BY FUND</b>		
ORDINARY CAPITAL	5,175,037	89.0%
FUND FOR SPECIAL OPERATIONS	418,130	7.2%
OTHER FUNDS	221,026	3.8%
<b>OUTSTANDING DEBT BALANCE</b>	<b>3,088,533</b>	
ORDINARY CAPITAL	2,986,958	96.7%
FUND FOR SPECIAL OPERATIONS	101,537	3.3%
OTHER FUNDS	38	0.0%
<b>APPROVED BY SECTOR</b>		
AGRICULTURE AND FISHERY	527,308	9.1%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	634,654	10.9%
ENERGY	274,763	4.7%
TRANSPORTATION AND COMMUNICATIONS	1,024,614	17.6%
EDUCATION	196,556	3.4%
HEALTH AND SANITATION	310,092	5.3%
ENVIRONMENT	0	0.0%
URBAN DEVELOPMENT	72,372	1.2%
SOCIAL INVESTMENT AND MICROENTERPRISE	493,122	8.5%
REFORM PUBLIC SECTOR MODERNIZATION	1,994,643	34.3%
EXPORT FINANCING	176,756	3.0%
PREINVESTMENT AND OTHER	109,313	1.9%

\* Net of cancellations with monetary adjustments and export financing loan collections



**INTER-AMERICAN DEVELOPMENT BANK**  
Regional Operations Support Office  
*Operational Information Unit*

# PERU

## STATUS OF LOANS IN EXECUTION AS OF JULY 31, 2002

(Amounts in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED	AMOUNT DISBURSED	% DISBURSED
1996 - 1997	4	298,300	250,345	83.92%
1998 - 1999	5	567,708	196,288	34.58%
2000 - 2001	5	186,800	31,084	16.64%
2002	1	300,000	200,000	66.67%
<b>TOTAL</b>	<b>15</b>	<b>\$1,352,808</b>	<b>\$677,717</b>	<b>50.10%</b>

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\* Net of Cancellations . Excluding export financing loans.



Inter-American Development Bank  
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## Peru

### Tentative Lending Program

#### 2002

Project Number	Project Name	IDB US\$ Millions	Status
PE0211	Fiscal Reform Program	300.0	APPROVED
PE0193	Foncodes III	150.0	
PE0219	Trade Policy Development Prog.	5.0	
PE0217	Modernization of the State and Decentralization Prog.	28.0	
*PE0222	Camisea Project	75.0	
PE0233	Inst. Environmental Strengthening of the Camisea Project	5.0	
*PE0216	Grana y Montero ("G&M") Partial Credit Risk Guarantee	15.0	
PE0218	Support to the Housing Sector Program	60.0	
<b>Total - A : 8 Projects</b>		<b>638.0</b>	
PE0220	Institutional Support of the Congress	7.0	
*PE0235	Road Network	19.5	
<b>Total - B : 2 Projects</b>		<b>26.5</b>	
<b>TOTAL 2002 : 10 Projects</b>		<b>664.5</b>	

#### 2003

Project Number	Project Name	IDB US\$ Millions	Status
PE0223	Strengthening and Modernization Tax System Administration	8.0	
PE0142	Sanitation Sector Devel. Support Prog.ii	50.0	
PE0203	Science and Technology Program	35.0	
PE0207	National Statistics System Strengthenin	15.0	
PE0236	Support to Departmental Highway Decentralization	100.0	
PE0187	Urban Transport in Lima	40.0	
PE0200	Public Investment System	10.0	
PE0232	Fiscal Strengthening at the Customs Service Stage III	4.0	
<b>Total - A : 8 Projects</b>		<b>262.0</b>	
PE0234	Support Services to the Rural Competitiveness	32.0	
PE0213	Urban Renewal of Downtown Lima	39.0	
<b>Total - B : 2 Projects</b>		<b>71.0</b>	
<b>TOTAL - 2003 : 10 Projects</b>		<b>333.0</b>	
<b>Total Private Sector 2002 - 2003</b>		<b>109.5</b>	
<b>Total Regular Program 2002 - 2003</b>		<b>888.0</b>	

\* Private Sector Project



**STAGE THREE OF THE NATIONAL PROGRAM TO SUPPORT OPERATIONS OF  
THE COMPENSATION AND SOCIAL DEVELOPMENT FUND  
(FONCODES III)**

**(PE-0193)**

**EXECUTIVE SUMMARY**

<b>Borrower/ Guarantor:</b>	Republic of Peru	
<b>Executing agency:</b>	Fondo Nacional de Compensación y Desarrollo Social [National Compensation and Social Development Fund] (FONCODES)	
<b>Amount and source:</b>	IDB: (OC)	US\$150.0 million
	Local:	<u>US\$ 37.5 million</u>
	Total:	US\$187.5 million
<b>Financial terms and conditions:</b>	Amortization period:	25 years
	Grace period:	4 years
	Disbursement period:	4 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	U.S. dollar, Single Currency Facility
<b>Objectives:</b>	The general objective of the program is to help improve the quality of life and promote socioeconomic development in the country's poorest rural communities, by providing better access to basic social and economic infrastructure and building capacity to obtain a sustained increase in income.	
<b>Description:</b>	The program has been designed based on: (i) the results of the evaluations of the previous stages of FONCODES; (ii) the fund's new institutional structure when it becomes part of the future ministry of human and social development or the ministry in charge of social policy; (iii) the role that the new government has assigned to FONCODES in its strategy to tackle poverty and provide economic opportunities for the poor; (iv) the role assigned to FONCODES as a tool to support local governments in rural areas prior to full introduction of decentralization; and (v) the role that FONCODES will play with the line ministries and other government agencies.	

The program will have three components: (i) **Investment**, with three subcomponents: (a) basic social and economic infrastructure; (b) consolidation of the strategic development clusters (REDs); and (c) rehabilitation of existing works; (ii) **Training and institution building**, with three subcomponents: (a) training and strengthening of community management; (b) institutional strengthening and equipment for FONCODES; and (c) training in social management, planned and carried out by in Peru by the Inter-American Institute for Social Development (INDES); and (iii) **Follow-up, evaluation and auditing**, includes external monitoring, evaluations and external audits.

**The Bank's country and sector strategy:**

The general objective of the Bank's strategy in Peru is to reduce poverty and promote equity and social inclusion, ensuring strong and sustainable economic growth. To do this, the country will have to improve the efficiency of its social policy, boost the productivity of its economy and improve its institutions, all within a framework of fiscal balance. Activities in the sector have the following specific objectives: (i) to enhance the efficiency and effectiveness of social spending; (ii) to alleviate poverty and protect vulnerable groups from external shocks; (iii) to strengthen mechanisms for social inclusion and sustainable human development; and (iv) to spur participative leadership and management by society in social programs. The proposed operation supports achievement of these objectives.

**Environmental and social review:**

Even though evaluations show that women have played an important role in the executing units, the program includes actions to increase their participation in all stages of the project cycle (identification, preparation and execution). Training has also been included to promote increased participation by women in the strengthening of organizational and management capacity.

The indigenous population in the sierra, coast and jungle numbers almost 8.8 million people out of a total population of 26.8 million, i.e. indigenous people make up 33 percent of the population. Between 1991 and 2001, FONCODES financed 35,378 social and economic infrastructure projects, with 19,752 of them directly benefiting indigenous communities (see paragraphs 1.19 and 1.20). In other words, although they account for 33 percent of the population, these communities received 56 percent of the projects. However, most of these projects have benefited indigenous communities living in the Andes (see Table I-2). In this new stage, the program establishes a strategy that takes account of the conditions and specific needs of communities on the coast and in the jungle. Ethnoengineering instruments will be used and support will be provided for the Commission for Andean, Amazon and Afro-Peruvian Peoples

(CONAPAAA), which will directly promote social and economic infrastructure projects in the communities.

FONCODES included the environmental variable in the project cycle and made significant progress that was embodied in an environmental impact assessment guide for social projects. The results of the environmental audit performed by RE3 were positive. However, some areas that require improvement were identified. It is recommended that environmental management considerations be included in the midterm and final evaluations. FONCODES has begun to review its environmental impact assessment guides and manuals keeping the following aspects in mind, among others: (i) simplification of the language and procedures; (ii) diversification based on the main ecosystems (sierra, coast and jungle); and (iii) adaptation to the cultural diversity of those areas.

In the institutional part, the program plans to include an environmental unit in the infrastructure management office. Also, with a view to institutional strengthening, coordination is being established to have FONCODES' environmental work included in the national environment system.

FONCODES has raised awareness of environmental issues, particularly among the beneficiaries of potable water and sanitation projects. In the new stage, these activities will be stepped up during initial promotion and extended to all lines of projects financed by the Fund.

Last, the projects will obtain environmental certification from the environmental authorities, as established in Law 27446 of April 2001 on Environmental Impact Assessment, and the possibility of introducing voluntary certification (ISO 14000 or ISO 9001) will be studied with a view to providing value added for certain products, such as coffee, honey, alpaca hides, cotton and others.

**Benefits:**

The program will directly benefit poor rural communities by financing: (i) approximately 4,325 small projects to improve the quality of life in a similar number of communities, by promoting the use of education, health, potable water, sanitation, electricity and basic road services; and (ii) training in activities that will permit beneficiaries to improve their incomes and make better use of the services provided.

Social participation, which is a priority in the plans to decentralize and modernize the State, will be facilitated by the methodology used in the program, based on executing units. The methodology, which was used and evaluated in the two previous stages, will be strengthened in this third stage, by including a municipal representative in each unit.

By consolidating the strategic development clusters, the program is embarking on a path toward the sustainable improvement of rural communities that have development potential but have been unable to capitalize on it owing to the lack of training and basic support. This is a process that the program will support as the centerpiece of coordinated action with other public and private agencies, optimizing the use of resources and achieving greater synergy in these actions.

Last, the program will support the institutional development of FONCODES in keeping with government guidelines that seek to consolidate work in the social sector to avoid duplication of activities, overcome the lack of institutional coordination in the country and, in general, make better use of the internal and external resources spent on the social sector.

**Risks:**

**Personnel policy.** One potential risk is that management and professional positions might be filled with unqualified staff, losing the know-how and experience built up over the Fund's 10 years of existence. **Mitigating measure:** To maintain the Fund's high technical level, an agreement has been reached to ensure greater continuity in professional and managerial positions at headquarters and in the zone offices (ZOs). Where it is necessary to make changes or hire new technical or managerial staff, FONCODES will hold public competitions to fill the vacancies. The terms of reference for these competitions and the technical profiles of candidates will be agreed upon with the Bank prior to publishing the announcements. If this process is not complied with at any ZO, the funds committed by that office will not be included in the program, after the event occurs.

**Transparency and politicization.** Another risk refers to politicization and transparency in the allocation of resources. **Mitigating measure:** To mitigate this risk, apart from the rules and regulations governing program execution, FONCODES has established a Commission on Transparency, Ethics and Institutional Integrity (CTI), whose members are drawn from the Committee to coordinate the fight against poverty, the College of Engineers, the Office of the Public Ombudsman and other bodies. The committee will be treated as a unit that reports directly to FONCODES' board of directors. By promoting ethics and institutional integrity, this unit will complement the work of the Office of the Internal Auditor, which oversees the legality of procedures and the proper use of resources. In addition, reports on the committee's actions will be posted on FONCODES' web page and a portal is being designed that will include information about all projects financed by the Fund and their cost.

**Institutional framework.** Another risk is that the plan to decentralize and modernize the State that the country will carry out, under which FONCODES will play a relevant role in the social area, could be delayed or suffer distortions during implementation, which would affect the program. **Mitigating measure:** A special condition has been established that links commitment of part of the loan proceeds to satisfactory progress in this area (see special conditions and paragraph 3.4).

**Municipal weakness.** Another risk is the weakness in human and financial resources exhibited by the municipalities where FONCODES is active. This has a special impact on the process of transferring responsibilities included in the decentralization plan. **Mitigating measure:** The program will include in the most critical projects—such as drinking water projects—funds to finance monitoring after completion of the works. Specialized institutions will be contracted to perform the monitoring, which will last for about 18 months.

**Special  
contractual  
conditions:**

**Conditions precedent to the first disbursement:** (i) have begun the bid process with the international publication of the invitation to bid on the contract for consulting services to monitor the process (paragraph 2.32); (ii) have designed, approved, and implemented, where applicable, the methodology for identification of the baseline for project monitoring and evaluation (paragraph 3.7); (iii) have signed the agreement on the carry-over of resources between the government and FONCODES (paragraph 3.1); (iv) have received approval from FONCODES' board of directors to include the CTI as an organizational unit that reports to the organization's board of directors and have implemented that decision (paragraph 3.3); (v) have included the publication of all projects financed by the Fund on the FONCODES web page (paragraph 3.26); (vi) have signed or ratified, where they exist, inter-agency coordination agreements with the ministries of health; education; housing, construction and sanitation; and transportation and communications (paragraph 3.27); and (vii) have placed the Operating Regulations previously agreed upon with the Bank in effect (paragraph 3.28).

**Special conditions.** Two years after the start of the program or when 75 percent of resources are committed, whichever comes first, compliance with the following conditions will be reviewed: (a) FONCODES has been integrated institutionally with the ministry of women and social development or its equivalent; (b) within the context of the modernization and decentralization process, a local investment fund or its equivalent has been established that eliminates duplication and optimizes the use of the resources of the different

activities of existing social funds or programs; and (c) intervention mechanisms have been devised within FONCODES that are consistent with the new decentralization strategy. To continue committing resources, it will be necessary to have complied satisfactorily with all these obligations, which will be a special condition to be included in the contract (paragraph 2.33).

**Poverty-targeting and social sector classification:**

This operation qualifies as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Furthermore, this operation qualifies as a poverty-targeted investment (PTI). The borrowing country will be using the 10 percentage points in additional financing (see paragraph 4.4).

**Exceptions to Bank policy:**

None.

**Procurement:**

Standard Bank procedures will be followed in the procurement of goods and services and in the award of contracts for program works. International competitive bidding will be used for goods and services worth US\$250,000 and over. Although no major works are planned, international competitive bidding will be used whenever the cost is above US\$1 million. When the works are under US\$90,000, they will be executed on force account by the executing unit, which is permitted in Peruvian legislation, and the procedures are included in the respective FONCODES manuals. Nonetheless, it is recommended that national procedures be followed for their award, provided they do not conflict with Bank policies. International competitive bidding will be used for consulting services costing US\$200,000 and over. In all other cases, the Bank procedures included in Annex C of the loan contract will be followed.

## **I. FRAME OF REFERENCE**

### **A. Introduction**

- 1.1 The National Compensation and Social Development Fund (FONCODES) was established in 1991 as one of a series of measures to cushion the impact of macroeconomic adjustment. Unlike other social funds, FONCODES was not established with international financing, but arose as a national initiative. One important aspect of its design, which sets it apart from other social funds, is its basic objectives. On the one hand, it was designed as a tool for providing a rapid and effective response to the needs of the poor, who would be hardest hit by the adjustment that was beginning and, on the other, once macroeconomic stabilization had been achieved, it would support the social and economic development of those same groups, particularly the rural poor. This third stage of the program attaches particular importance to this last objective.
- 1.2 In the ten years that FONCODES has been active, it has made a significant contribution to the fight to alleviate poverty and restore the presence of the state in the country's most remote rural areas, where the network of basic social services is thin or nonexistent. Over the period, it has channeled local and external resources worth about US\$1.5 billion into financing more than 40,000 small projects, covering 99 percent of the districts classified as poor. The Fund has been supported in this work by the IDB and the World Bank, through loans totaling US\$500 million.
- 1.3 Stage three has been designed taking the following aspects into consideration: (i) the results of the different evaluations of the Fund; (ii) the projects already in FONCODES' pipeline that require financing; (iii) the role of FONCODES in the future ministry of human and social development or the ministry in charge of social policy; (iv) the role of FONCODES in the government's strategy to overcome poverty and provide economic opportunities for the poor; (v) the role of FONCODES in supporting local governments in rural areas prior to full introduction of decentralization; and (vi) FONCODES' relations with the line ministries and other government agencies.
- 1.4 A Local Investment Fund will be established through the merger of existing funds—FONCODES, the National Watershed Management and Land Consolidation Program (PRONAMACHCS), Cooperación Popular (COOPOP) and the National Development Institute (INADE), among others. In this context, the comparative advantages of FONCODES for forming the hub of the merger are clear: (i) since its creation, it has been a financing entity and not an executor of works; (ii) its network of zone offices (ZOs) permits it to work closely with communities and local governments in remote rural areas; (iii) its experience in supporting the establishment of executing units, which will henceforth include municipal representatives; and (iv) its low operating and administrative costs.

- 1.5 To achieve the goals described, institutional capacity and, in particular, human resources trained in social management are needed on all levels of the public administration, particularly on the local level, given the current decentralization process. The program will finance technical assistance to build institutions staffed with personnel equipped to meet this challenge. The training will be provided by the Inter-American Institute for Social Development (INDES), in cooperation with a number of universities, as described later in this proposal. In short, by incorporating all these considerations into its design, the program will support FONCODES in the framework of the government's social and political-administrative program.
- 1.6 Furthermore, consideration has also been given to the fact that FONCODES has agreements in force or in preparation with bilateral donors such as Kreditanstalt für Wiederaufbau (KfW), the United Kingdom's Department for International Development (DFID), the European Union and the Italian government, which finance projects with methodologies or scopes that differ from those of the program. The design allows for the program to be adjusted to include successful results found in the evaluations of those projects.

## **B. Macroeconomic framework**

- 1.7 After nearly four years of recession, the economy began to recover in the third quarter of 2001 and continued during the first quarter of 2002, with GDP growing by 3.4 percent. However, the sources of this growth are relatively narrow. While the primary sectors as a whole grew by 8.7 percent, the nonprimary sectors grew by just 2.4 percent. A single project, the Antamina mine, accounts for a substantial part of the growth in the primary sectors. Growth in the nonprimary sectors was largely accounted for by the impact of public spending on infrastructure. The main obstacle to a stronger recovery is linked to private investment, which is still below the levels reached during the 1993-1997 expansion.
- 1.8 The fiscal deficit grew from an average of 0.3 percent of GDP in 1997-1998 to an average of 2.9 percent in 1999-2001. In the Stand-By Arrangement signed with the International Monetary Fund in February 2002, the government made a commitment to reduce the deficit to 1.9 percent of GDP in 2002 and 1.4 percent in 2003. However, the drop of 12 percent in real tax revenues in the first quarter and growth of 4.5 percent in real nonfinancial spending in the same period indicate that the fiscal situation is worsening. As a consequence, the central government's deficit was 1.9 percent of GDP and the nonfinancial public sector deficit was 1.6 percent, which is very high in a country where the authorities are accustomed to obtaining a surplus in the first quarter of each year that accommodates the higher spending levels that normally occur in the other quarters.
- 1.9 The government is currently facing a wave of public discontent and regional government elections are slated for November of this year. There is the risk that



fiscal discipline will be relaxed to respond to this situation. Also, progress in privatization has been jeopardized by several government decisions. Signals of this kind have a negative impact on investor confidence.

## **C. Socioeconomic background**

### **1. Poverty**

- 1.10 The country has faced a difficult political situation in recent years, which deepened the economic crisis, heavily affecting the poor. In 1994, 53.4 percent of Peruvians lived in poverty, with the figure rising to 54 percent in 2000. However, it is important to stress that significant progress was made in mitigating extreme poverty in rural areas. In 1994, 36.2 percent of the rural population lived in extreme poverty, with the figure falling to 30.1 percent by 2000. Although the figure continues to be very high, it reflects positive results brought about by the actions taken in the poorest rural areas.<sup>1</sup>

### **2. Access to basic services**

- 1.11 Although social spending evolved positively over the last decade, rising from 3.9 percent of GDP in 1990 to 7.9 percent in 2000 and from 38.2 percent of the country's general budget in 1990 to 43.9 percent in 2002,<sup>2</sup> basic services such as drinking water, sanitation and electricity are still beyond the reach of many Peruvians, particularly in rural areas.
- 1.12 **In the health sector**, access to services by the most vulnerable population continues to be limited. However, a relevant indicator such as infant mortality has improved significantly over the decade. In 1990, the national index was 57.2 deaths per thousand live births, which fell to 33 in 2000. The situation is different when the data are broken down into urban and rural areas. In metropolitan Lima, the infant mortality rate is 20 per thousand live births, while the figure is nearly 80 per thousand in provinces such as Yauyos.<sup>3</sup>
- 1.13 **In education**, although general coverage rose over the decade, there are major differences between urban and rural areas. In 1999, 62.5 percent of children between the ages of 3 and 5 attended preschool and 96.9 percent between the ages of 6 and 11 attended primary school. When the figure is broken down, 67.4 percent of children from 3 to 5 in urban areas attended preschool, compared to 56.1 percent in rural areas. For the 6-11 year age group, coverage is 97.1 percent in urban areas

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<sup>1</sup> *Pobreza y desigualdad en el Perú durante la década del 90*. César P. Bouillón and José Montes.

<sup>2</sup> *Lineamientos básicos de Política Social*, MEF, Lima, January 2001.

<sup>3</sup> *Los Niños Primero: estudio del gasto social focalizado en niños en el Perú*. Vásquez and Mendizabal, Save the Children, Sweden/Universidad del Pacífico, Lima 2001.

and 94.5 percent in rural ones. In urban areas, 94 percent of schools have drinking water and 89 percent have electricity, compared to 46 percent with water in rural areas and just 16 percent with electricity.<sup>4</sup>

- 1.14 **In potable water.** National coverage is 74.1 percent of households, although urban coverage is 90.7 percent in contrast with rural areas, where just 42.8 percent of households have connections and 15.1 percent have access to public taps. As for sanitation, 61.3 percent of the total population has sewer service, but in rural areas the figure tumbles to 13 percent. About 22.4 percent of the country's households do not have electricity, with the figure climbing to 56 percent in rural areas.

#### **D. The National Compensation and Social Development Fund (FONCODES)**

- 1.15 In 1993, the Inter-American Development Bank (IDB) and the World Bank granted loans for US\$100 million each to help finance FONCODES I, which had a total cost of US\$495 million, including the local counterpart, but excluding contributions from other donors such as the KfW. The first stage chiefly involved social assistance and the provision of basic social infrastructure in rural and marginal urban areas. To a lesser extent, economic infrastructure projects were financed, such as basic local roads and small irrigation works.
- 1.16 Stage two, approved in May 1996, had a total cost of US\$430 million and was cofinanced by the two Banks, which each contributed US\$150 million. The funds were used to finance about 15,500 projects. This stage sought to consolidate community participation throughout the project cycle, strengthen the gender approach, establish ex ante environmental assessment of projects and promote community participation in maintaining the works. The sphere of action was limited to remote rural areas (villages with between 40 and 400 families). The operational part adopted a more deconcentrated execution plan, by establishing 23 zone offices with the authority to process and approve projects. The program included a subcomponent for US\$12.4 million to finance pilot productive projects. The funds were used to finance 18 strategic development clusters (REDs), which are evaluated below.

#### **E. Evaluations**

- 1.17 Five evaluations were performed during stage two: three ex post project evaluations, one evaluation of productive projects, and one program impact evaluation. They were carried out by independent firms contracted through competitive bidding. The World Bank also wrote a project completion report for this stage and the KfW evaluated its participation in the Fund. FONCODES was one of the six programs included in a comparative study conducted by the World

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<sup>4</sup> *Diagnóstico en educación.* Arlette Beltrán, Centro de Investigación Universidad del Pacífico.

Bank (Rawlings *et al.*, 2001) and one of the seven included in the comparative study conducted by the IDB (Goodman *et al.*, 1997). FONCODES was also one of ten RE3 projects that were subject to environmental audits. The main results of these evaluations, which have been fundamental in the design of the proposed operation, are discussed below and a summary is presented in the technical files of the program.

## 1. Focus

- 1.18 Two-thirds of the total investment benefited poor or extremely poor communities and just 3 percent went to nonpoor communities (Table I-1). These figures are consistent with the results of the study by Paxson and Shady (World Bank, 1999), which determined that the focus of FONCODES was better than the focus of other social programs in Peru, while Goodman et al. considered it to be among the best in Latin America (IDB, 1997).

**Table I-1**  
**Distribution of FONCODES spending 1997-2000**  
**thousands of Soles**

Poverty status	Acceptable	Passable	Poor	Very poor/extremely poor
Investment	1,375	30,761	348,655	750,455
%	0.12	2.72	30.82	66.34

Source: World Bank Report 22019-PE

- 1.19 **Participation by indigenous communities.** The distribution of projects by ethnic groups shown in Table I-2 points to the imbalance between Afro-Peruvian and Amazon groups and groups living in the high Andes.

**Table I-2**  
**Distribution of the beneficiary population by ethnic group**  
**(Social and economic infrastructure projects financed between 1991-2001)**

Population group	Population		Projects	
	Number	%	Number	%
Afro-Peruvian	254,125	1.0	74	0.2
High Andes indigenous	8,250,000	30.8	18,378	51.9
Amazon indigenous	350,000	1.3	1,300	3.7
Subtotal	8,854,125	33.1	19,752	55.8
Nonindigenous	17,895,875	66.9	15,626	44.2
Total	26,750,000	100.0	35,378	100.0

Source: National Statistics Institute

- 1.20 In this stage, actions have been coordinated with the Commission for Andean, Amazon and Afro-Peruvian Peoples (CONAPAAA) to promote participation by Afro-Peruvian and Amazon indigenous communities, as will be described later.

## **2. Impact**

- 1.21 Until the end of the 1990s, evaluations were based almost exclusively on beneficiary opinions. In 2000, a methodology was designed to measure the impact of investments more precisely, using a control group. The main results are presented below.
- 1.22 **Education.** On average, there was an increase of one classroom per school in comparison with the control group, enrolment rose by 34 students per school and the number of grades offered increased by 1.6. The number of teachers grew by 1.2 and the number of schools with drinking water by 35 percent. The student/teacher ratio fell from 31:1 to 29:1. The retention rate showed an average increase of 0.08 years schooling and for children between the ages of 10 and 14 the figure was 0.2 years.
- 1.23 **Potable water.** In communities that received assistance, diarrhea in children 10 years of age and under has fallen by 2.8 percent and severe diarrhea by 1.7 percent. Econometrically, both these differences are highly significant—5 percent and 3 percent each. Mortality among children five and under fell by 2.4 percent, which is also econometrically significant. The time spent to obtain water fell by 66 percent in cases where household connections were installed and by 59 percent for families using public taps.
- 1.24 **Sewers and latrines.** These projects did not show significant results and no relevant changes were detected in the incidence of diarrhea or mortality. The main reason for this low impact is probably that the projects did not include the provision of connections and, given their high cost, over half of the families have not hooked up to the system. In projects that built latrines, it was found that they reduced the incidence of severe diarrhea by 2.4 percent.
- 1.25 **Economic infrastructure: irrigation and roads.** In nine irrigation projects, arable land increased by an average of 33 percent and production per hectare rose between 7 percent and 50 percent, depending on the crop, which benefited small farmers with operations of less than 1 ha up to 2.5 ha. As for roads, the beneficiary communities began to have access to public transport two or three times a week, which permitted them to connect more easily to local markets and allowed for the arrival of new basic services.
- 1.26 **Sustainability.** No problems with sustainability have been observed with schools or health posts, since the ministries in charge have shouldered this responsibility. However, there are problems with the water and sewer works: 7 percent of the

water systems and 6 percent of the sewer systems were not working. Just 1 percent of the projects built in 1999 were not operating, but the trend is for the figure to rise over time. An additional problem was the lack of funds for project maintenance. Just 46 percent of the communities had a water system that required users to pay, while the others did not have funds to devote to operating and maintenance.

- 1.27 **Costs.** The World Bank evaluation of FONCODES shows that operating and construction costs are low compared to the values for the National Institute for Education and Health Infrastructure (INFES), PRONAMACHCS and CARE, as per Table I-3.

**Table I-3**  
**Cost comparison (US\$)**

	FONCODES	INFES	PRONAMACHCS	CARE
1. Schools				
– Cost per m <sup>2</sup>	199	353	-	-
– Cost per classroom	10,820	41,568	-	-
– Cost per student	328	496	-	-
2. Irrigation				
– Cost per ha	242	-	308	-
3. Potable water				
– Cost per family	270	-	-	332

Source: World Bank, Report 22019-PE, page 19

### 3. Environment

- 1.28 RE3 performed an environmental audit of 10 projects in eight countries in 2001, one of which was FONCODES.<sup>5</sup> In the executive summary, the report stated that: “...the program has facilitated the construction of a very considerable number of small infrastructure works with a very positive social, economic and environmental impact. The incorporation of environmental management procedures and actions has allowed the works and the professionals working on them to attain increasingly high levels of technical and environmental feasibility. The program is among the best of its type in the region ...”. It also presented aspects that should be improved, such as the application of operating guides and manuals for environmental assessment and the environmental risk project classification system; monitoring of the application of mitigation measures; training in environmental management for employees of FONCODES and the executing units, etc.

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<sup>5</sup> *Informe de Auditoria Ambiental de FONCODES*. Paul Dulin, 2001.

#### **4. Productive projects (strategic development clusters - REDs)**

- 1.29 Since 1995, FONCODES has financed productive projects that acted as experimental rural development models for achieving a sustained increase in productivity and income in poor rural communities. The focus of these projects has been evolving in function of their results. The most recent involves work with rural community groups that are linked by geography or economic potential (REDs) and close to US\$17 million has been invested to develop 33 of these REDs, 18 of which were financed with proceeds from the IDB and World Bank loans.
- 1.30 In 2001, an independent evaluation was performed of the REDs financed by the IDB and World Bank. Eleven of the 18 networks were selected to examine the changes in production, crop yield and operating costs.<sup>6</sup> The review concluded that the REDs were successful and that the experience should be expanded. Average growth in production value was found to be double the total cost of the project, including interest on working capital, arrears, the cost of FONCODES' technical assistance and the cost of preparing the land for cultivation.
- 1.31 The weaknesses identified included: (i) scant complementarity and coordination with other rural programs carried out by other institutions; (ii) insufficient time to consolidate the results; (iii) little transfer of management skills; and (iv) the absence of support for nonagricultural production.

#### **F. The country's strategy in the sector**

- 1.32 The country is preparing a strategy to overcome poverty and provide economic opportunities for the poor, which is expected to be adopted by the government at the end of 2002. FONCODES plays a central role in the strategy because it: (i) creates economic opportunities for the poor; (ii) trains and strengthens rural communities; and (iii) promotes increased participation and oversight by society.

#### **G. The Bank's country and sector strategy**

- 1.33 The Bank's strategy in Peru is to reduce poverty and promote equity and social inclusion, ensuring high and sustainable economic growth rates. To do this, the country will have to improve the efficiency of its social policy, boost the productivity of its economy and improve its institutions, all within a framework of fiscal balance. Activities in the sector have the following specific objectives: (i) to enhance the efficiency and effectiveness of social spending; (ii) to alleviate poverty and protect vulnerable groups; (iii) to strengthen mechanisms for social inclusion and sustainable human development; and (iv) to spur participative leadership and management by society in social programs. The proposed program will support

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<sup>6</sup> *Informe Final, CIMA S.A., and Resumen de Evaluaciones a FONCODES*, Samuel Morley.

these objectives by financing small projects with a view to: (i) improving access by vulnerable groups to basic infrastructure services; (ii) building capacity to improve the income of poor communities; (iii) supporting participation by local organizations and governments in the project cycle; and (iv) supporting the institutional development of FONCODES.

## **H. Program strategy**

- 1.34 The program has been designed on the basis of the criteria and parameters described (in paragraph 1.3), is consistent with the government's plans, and will support FONCODES in carrying out its mandate in a context of reforms, supported by the Bank through two fiscal reform sector loans (PE-0211), which aim to improve the sustainability of present levels of public spending and will contribute to the fiscal sustainability of the FONCODES program. Policies and mechanisms are also being implemented to target spending to the poorest populations. FONCODES, given its design and objectives, is one of the best focused social programs. Consideration has also been given to the fact that FONCODES has agreements in force or in preparation with bilateral donors, who finance projects with methodologies or scopes that differ from those of the program. The design allows for adjustments to include successful results found in the evaluations of those projects.

## II. THE PROGRAM

### A. Objectives

- 2.1 The general objective of the program is to help improve the quality of life and promote socioeconomic development in the country's poorest rural communities.
- 2.2 The specific objectives are to support the country in its efforts to: (i) increase access by the poorest groups to basic social and economic infrastructure services; (ii) build capacity to permit poor families to raise their income; (iii) include participation by local governments in the project cycle; and (iv) strengthen the positioning of FONCODES in the government's social, poverty-alleviation and State modernization plans.

### B. Program structure

- 2.3 The program will have three components to achieve its objectives: (i) **investment**, with three subcomponents: (a) basic social and economic infrastructure projects; (b) consolidation of productive projects (REDs); and (c) rehabilitation of existing works; (ii) **training and institution building**, with three subcomponents: (a) training and strengthening of community management; (b) institutional strengthening and equipment for FONCODES; and (c) training in social management, planned and carried out by in Peru by the Inter-American Institute for Social Development (INDES); and (iii) **follow-up, evaluation and auditing**, which includes: (a) general program monitoring; (b) mid-term and final evaluations, that will include environmental and gender equity considerations; and (c) external audits. The expected outcomes at the end of the program and the indicators, means of verification and assumptions are presented in detail in Annex II-1

#### 1. Investment (US\$173.4 million)

- 2.4 This component will finance approximately 4,325 small projects, whose features are described below. To facilitate participation in the program by Afro-Peruvian and Amazon communities, up to US\$5 million will be used to finance projects promoted and presented by the Commission for Andean, Amazon and Afro-Peruvian Peoples. The Operating Regulations include general and specific eligibility criteria for each type of project.

##### a. Social and economic infrastructure (US\$115.6 million)

- 2.5 FONCODES will finance the cost of works in each beneficiary community, which will be carried out on force account by the executing unit, in addition to the cost of training, which will be administered by FONCODES together with the executing units. The total cost of each project includes both types of financing.



- 2.6 **Education (US\$25 million).**<sup>7</sup> About 840 projects will be financed for rehabilitation, replacement or construction of new classrooms in kindergartens and primary schools, equipped with basic school furniture. The construction materials used will be those that predominate in the zone, provided they are acceptable to the Ministry of Education. The average cost of these projects is US\$30,000, which includes the cost of technical training during execution.
- 2.7 This activity has been coordinated with the Ministry of Education, which has designated FONCODES as the agency in charge of executing the infrastructure of a rural education program with World Bank financing. A master plan cofinanced by both Banks has been established, based on FONCODES' methodology and supervised by the Ministry of Education.
- 2.8 **Health (US\$5 million).**<sup>8</sup> The rehabilitation or replacement of approximately 145 primary health posts will be financed, including basic equipment. The average cost of these projects is US\$35,000, which apart from the direct project costs, includes the cost of technical training during execution of the works. These projects will be carried out in coordination with the Ministry of Health and the health posts are based on its prototypes. No-frills housing for health professionals has been included in remote areas.
- 2.9 **Potable water (US\$32 million).**<sup>9</sup> Approximately 900 water projects will be financed. They have been designed using appropriate technologies to facilitate operation and maintenance and to minimize costs. Eligible projects include conventional systems and unconventional systems such as distribution through public taps. These projects are estimated to cost an average of US\$36,000 each including community and technical training during execution and the monitoring period.
- 2.10 The design and scaling of this subcomponent have been closely coordinated with the Vice-Ministry for Sanitation, since it will execute a national rural potable water program (PRONASAR) with World Bank financing, mainly directed to strengthening the management and operation of water and sanitation systems. Just as for the schools, FONCODES will execute the works. A master plan has been established, cofinanced by both Banks and supervised by the vice-ministry. This coordination includes operating agreements such as: (i) the use of technical standards for design and construction and, in particular, for operation and maintenance, based on minimum economic cost criteria; and (ii) the introduction of tariffs to cover operating and maintenance costs, as a minimum. To ensure sustainability, the projects will be monitored technically for up to 18 months after

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<sup>7</sup> US\$23.7 million for works and US\$1.3 million for training.

<sup>8</sup> US\$4.3 million for works and US\$700,000 for training.

<sup>9</sup> US\$29.2 million for works and US\$2.8 million for training.

the work is completed. The monitoring will be contracted out and the purpose will be to deepen and strengthen the organization in charge of operation and maintenance. The projects will be selected using cost-efficiency indicators as a means of ensuring that the solutions are suitable and represent the least cost.

- 2.11 **Sanitation (US\$7 million).**<sup>10</sup> Approximately 200 expansion projects for existing sewer system or new systems will be financed, but only in cases where at least 75 percent of households are provided with residential hook-ups. The average cost is an estimated US\$34,000, which includes technical and community training and monitoring after completion of the works. The systems will be selected using economic criteria and will include, as pertinent, general systems, chambers, treatment plant and residential connections. The latrine projects may cover an entire locality or community, providing one latrine per household. The design and scaling of this subcomponent have also been coordinated with the Vice-Ministry of Sanitation.
- 2.12 **Basic roads (US\$27 million).**<sup>11</sup> Four hundred and fifty basic road projects will be financed, such as single-lane local roads for vehicles, drains, fords, side ditches, etc. Small bridges for vehicles and footbridges will also be financed. The average cost of these projects is US\$60,000 and includes technical training during and after execution. Since FONCODES works in zones where the only means of transport is by water, small river wharves, floating docks, etc, will be financed.
- 2.13 The design and scaling of this subcomponent have been coordinated with the Rural Roads Program Coordinating (PCR) Unit which is partly financed by the IDB. The PCR works mainly on activities to preserve rural roads, with municipal participation in the maintenance and cofinancing of works. Coordination includes operating agreements on the use of technical standards and environmental manuals for design, construction and, in particular, maintenance, all designed and applied by the PCR.
- 2.14 **Electrification (US\$10 million).**<sup>12</sup> This line will finance 250 projects for secondary electric grids, basically consisting of self-supporting cables suspended from wooden posts and residential connections up to the meter. It will also finance projects that use other systems suitable for rural areas, such as windmills, photovoltaic systems with solar panels, etc. The average cost of these projects is US\$40,000, including the cost of technical training.

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<sup>10</sup> US\$6.5 million for works and US\$500,000 for training.

<sup>11</sup> US\$26.3 million for works and US\$700,000 for training.

<sup>12</sup> US\$9.6 million for works and US\$400,000 for training.

- 2.15 **Economic infrastructure (US\$9.6 million).**<sup>13</sup> This subcomponent is not large in scale and, although it maintains the principle of respect for community priorities, its geographic focus is on the 11 socioeconomic micro-corridors that are described further on. The idea is to obtain better synergy among the investments to be made. The subcomponent includes: (i) **irrigation** works and will finance approximately 420 small irrigation works and systems directly linked to production processes, costing an average of US\$15,250; (ii) **marketing support works** that will finance about 210 post-harvest works, such as collection centers, processing centers (grain mills), installations for trade fairs, etc., with the purpose being to facilitate marketing and confer higher value added on production, at an average cost of US\$7,800; and (iii) **land improvement and reforestation**, which will finance 250 projects, such as infiltration ditches, terracing and contour terrace construction, reforestation and natural and cultivated pasture management programs, protection of farmland against erosion. The average cost is US\$5,900.

**b. Consolidation of productive projects (US\$21 million)**

- 2.16 The productive projects will expand and consolidate the actions begun in the previous stage, technical assistance and credit support, which will take different approaches to: (i) **technical assistance**, which will pay much more attention to markets and income-earning opportunities inside and outside farming; (ii) **credit**, which will not form part of the program but will be provided under FONCODES' microlending program, with the funds to be placed in a trust administered by Corporación Financiera de Desarrollo [Financial Development Corporation] (COFIDE), which will provide the funding in accordance with its own financial procedures, and will be operated by formal credit institutions (under this plan, FONCODES does not participate in the selection of borrowers, does not guarantee the loans or assume the risk of the operation); and (iii) **project scale**, which will support 11 socioeconomic micro-corridors (SMCs), each of which will have about six REDs and a population of about 30,000. This will make economies of scale possible in the delivery of technical assistance and potential externalities in marketing, shipping and the provision of credit. A total of 650 capacity-building projects will be financed, at an average unit cost of US\$30,700.
- 2.17 Technical assistance and training for communities will be financed in each SMC, coordinating activities with local governments and relevant national government units, to develop and carry out projects or business plans in each RED. The main objective is to build the capacity to sort out the bottlenecks that stand in the way of adequate production processes and linkage to markets. The following will be financed: (i) technology, production diversification, improvements in quality and productivity; (ii) strengthening of economic and business organizations to enable them to participate in the market for goods and services; (iii) promotion of business

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<sup>13</sup> US\$8.3 million for works and US\$1.3 million for training.

opportunities and mechanisms for market linkage, through the timely provision of information; (iv) integrated farm management and sustainable management of natural resources; and (v) local and economic management for sustainable positioning in the agri-food market.

- 2.18 The strategy includes complementary actions to support the development of market-oriented businesses. (i) **investments in economic infrastructure** will be financed to solve problems in production and marketing. The investments will mainly be in small irrigation, post-harvest, marketing and/or processing infrastructure; (ii) **support for access to financial services** will be provided, seeking to develop financial markets in poor zones and promoting a match between supply and demand for those services. On the demand-side, the program will enhance the beneficiaries' capacity to manage and comply with their financial obligations and on the supply-side, it will promote participation by supervised financial institutions in rural areas, specifically in the SMCs. Processes of this kind have been launched in some parts of the country by United States Agency for International Development (USAID), with good results; and (iii) **complementarity with other players** will be sought, through the creation of an inter-agency coordination committee in each SMC, which includes all public and private agencies that are active in the area.
- 2.19 The subcomponent will work with the 11 SMCs that were identified on the basis of the following criteria: (i) existence of a RED in the zone; (ii) zone with a concentration of poor inhabitants; (iii) potential for economic and productive development; (iv) market access; (v) accessibility by road; (vi) levels of organization and participation by the population involved; and (vii) presence of other public and private institutions that promote rural development.

### **c. Rehabilitation of social infrastructure (US\$36.8 million)**

- 2.20 Approximately 660 projects to rebuild social infrastructure will be financed at an average cost per project of US\$56,100, including materials and wages. About 9,900 works that were financed and/or executed by different institutions or by the community itself, but which are presently unable to adequately provide the service for which they were designed, will be rehabilitated,. An important additional benefit is the creation of temporary jobs in the rural communities. A rehabilitation project will include an average of 15 works, such as local roads, pack trails, foot and vehicle bridges, foot paths, small irrigation systems, potable water systems, drains, classrooms, health posts, etc.

## **2. Training and institution building (US\$6.83 million)**

- 2.21 Training is a crucial element in the social and economic development of low-income rural communities. Therefore, the program includes activities that will be targeted to the beneficiary communities, regional and local entities directly linked

to their development, and other institutions involved in social development on the national level. This component includes the three subcomponents described below.

**a. Training and strengthening of community management (US\$2.8 million)**

- 2.22 This subcomponent will take steps to boost community capacity in organizational planning and project prioritization, execution, operation and sustainability. The task will involve two lines of work: (i) initial promotion, financed with funds for this subcomponent, which will include different activities, depending on whether social and economic infrastructure projects are involved and whether productive projects are being consolidated; and (ii) community training, financed under the investment component, for social and economic infrastructure projects.

**(i) Initial promotion (US\$2.38 million)**

- 2.23 **Initial promotion in the communities.** Infrastructure project promotion will be financed in 5,000 communities. Based on past experience, 80 percent of them will end up presenting projects. The work will last for an average of one week per community and will cost an estimated US\$300 each, including professional fees, travel costs, per diems and supporting materials.
- 2.24 In the project cycle, promotion is the mainstay of preinvestment and is intended to publicize the options offered by FONCODES and raise community awareness of different issues, such as belonging, gender equity and environmental conservation, and booklets will be distributed on them. The community will also be provided with information about other possibilities for obtaining public funds to develop basic infrastructure projects, and the conditions and commitments their execution demands. Support will be provided for holding community meetings to prioritize projects, culminating with the election of an executing unit.
- 2.25 **Initial promotion to consolidate the REDs.** Promotion activities will be financed in 800 communities. This work will involve an initial phase lasting three months at an estimated cost of US\$1,100 for each community, including professional fees, travel and supporting materials. Initially, work will be done with public and private institutions that support rural businesses in the areas of information and sensitization. As in the previous case, the community will be sensitized to issues such as belonging, gender equity and environmental conservation and information booklets will be distributed. Subsequently, the program will be promoted directly with groups of communities to identify and prioritize the business options to be supported by it. This promotion will culminate with the presentation of a project profile and the election of an executing unit.

**(ii) Training for communities (US\$420,000)**

- 2.26 **Training for infrastructure projects.** About 4,500 communities will be offered training, whose cost will be included in the total project cost. Separate financing will only be provided for educational materials, estimated as US\$420,000. This activity, which will be contracted out as described in Chapter III, has the general objective of building up capacity in the community and its leaders to strengthen community management processes. The training will have two parts: (i) technical, depending on the type of project, and focussing on construction, use and maintenance of works and on their management, administration and sustainability; and (ii) cross-cutting, focussing on community participation, gender equity, the environment and community organization.
- 2.27 The technical training will be provided in two stages: (i) during preinvestment and execution, for approximately five months at a cost of US\$1,500 per intervention; and (ii) during post-project monitoring for 18 months at a cost of US\$2,000. This second stage will only be applicable to potable water projects and will take the form of periodic visits to provide technical assistance and strengthen the management committees, and improve coordination with local governments with regard to project sustainability.

**b. Strengthening and equipment for FONCODES (US\$2.7 million)**

- 2.28 This subcomponent will finance the development and implementation of an operations adjustment and equipment modernization plan, particularly in the information systems area, on the central level and in the zone offices, adapting them to the roles that FONCODES will be called upon to play.
- 2.29 A plan to reinforce information systems will be financed, which responds to requirements for applications, programs and process automation, chiefly for the administrative/financial and project management systems. Software will be procured or written and training in its use will also be financed in the zone offices and at headquarters. The estimated cost is US\$1.9 million.
- 2.30 Training for FONCODES' personnel at headquarters and in the zone offices will also be financed. The main areas are the strategic vision of program intervention, national rules on investment projects, gender, environment, decentralization, and ethics and institutional integrity. The training will be provided through workshops, seminars, planning exercises and specific courses. For subjects requiring greater specialization, such as information systems, training will be outsourced under contracts with universities or professional institutes. The total cost of the institutional training plan, including the work of preparing specific instruments, is an estimated US\$800,000.

**c. Training in social management (US\$1.75 million)**

- 2.31 Approximately 550 professionals and technicians from the central, departmental and municipal governments, leaders of nongovernmental organizations (NGOs), academics and others will receive this training. Organizations that design and manage social policies and programs will be strengthened, professionals and directors of social programs will be trained and national institutional capacity to offer training in social management will be built up. The courses will stress policy design and good practices in financing, organization and management of the delivery of social services. The program will only finance the direct incremental costs of INDES, which will not receive any other type of financing.

**3. Follow-up and evaluation (US\$2.05 million)**

**a. External follow-up (US\$1.1 million)**

- 2.32 The program will be monitored permanently to identify problems that could hamper execution and propose timely solutions to them. An independent consulting firm will be contracted for that purpose, whose terms of reference will include; (i) processes of institutional change on the national level that could directly or indirectly affect FONCODES; (ii) the linkage between FONCODES and public and private institutions related to its work; (iii) management of the zone offices and their linkage to regional and local governments and agencies and communities; (iv) timely updating of the indicators to be used to measure program impact; (v) execution of environmental protection and impact mitigation measures; and (vi) on-going advisory and technical assistance activities for management and line units, proposing solutions to any problems found. The consulting firm will be required to present bimonthly reports to FONCODES and the Bank on progress in the program, problems encountered and solutions proposed. The firm will be contracted through competitive bidding in accordance with Bank rules and the cost is an estimated US\$1.1 million. Since the firm should begin work as soon as possible after the program gets underway, having begun the bid process with the international publication of the invitation to bid will be a condition precedent to the first disbursement. The design, approval, and implementation, where applicable, of the methodology for identification of the baseline for project monitoring and evaluation will also be a condition precedent to the first disbursement.

**b. Evaluations (US\$860,000)**

- 2.33 **Mid-term evaluation.** Given FONCODES' objectives and the institutional changes to be introduced by the government during execution, the program will be evaluated in two parts. A mid-term evaluation will be performed to measure operational effectiveness and determine whether FONCODES has successfully integrated into central government's reorganization and decentralization and participative processes. This evaluation will be performed two years after the

program begins or when 75 percent of the resources have been committed, whichever comes first. The evaluation will review fulfillment of the following: (i) FONCODES has been institutionally integrated into the ministry of women and social development or its equivalent; (ii) within the context of the modernization and decentralization process, a local investment fund or its equivalent has been established that eliminates duplication and optimizes the use of the resources of the different activities of existing social funds or programs; and (iii) intervention mechanisms have been devised within FONCODES that are consistent with the new decentralization strategy. The above will be a special condition to be included in the loan contract. The uncommitted balance of the loan will only be released after this condition has been complied with to the Bank's satisfaction. The estimated cost of the evaluation will be US\$160,000.

- 2.34 **Final evaluation.** The final evaluation will consist of two parts which are linked but which have different objectives. The first refers to operational, institutional and managerial aspects, in which FONCODES' efficiency will be evaluated. The second will measure the program's impact on the target population. The methodologies will be similar to those used in the previous stage, with some adjustments and the inclusion of some new indicators in the baseline. The information to be compiled on program beneficiaries will be broken down by region (sierra, coast and jungle), gender and ethnic group.
- 2.35 To evaluate FONCODES' performance, information will be obtained for a random sample of projects through surveys of the different players in the project cycle. The information will refer to the quality of the projects, whether they have operated normally, whether the beneficiaries are satisfied with the operation of the project and the support provided by FONCODES during the different stages of the project cycle, whether the procedures used to determine project priorities represent a community decision, whether the environment has been affected by the projects, whether the impact mitigation measures have been executed with the necessary quality and timeliness, etc. Special information will be compiled on sustainability and institutional and management aspects at headquarters and the zone offices.
- 2.36 The methodology for measuring the program's impact uses three key elements: (i) indicators for each type of project; (ii) a baseline that is linked to those indicators in each intervention; and (iii) control communities that have not received financing but are similar in nature to the communities that have received it, to be identified from the FONCODES database. Use of these three elements will shed light on the differences or improvements in the quality of life of the poor as a result of program interventions. For productive projects, the main indicator is per capital income. Before making any investments, FONCODES will prepare a baseline, using a household survey whose results will serve as the initial value for the per-capita income indicator in each of the 11 SMCs where the program will be active. In parallel, comparable districts close to the corridors will be identified and used as control groups, where household surveys will also be conducted to determine



income levels and other household characteristics. Special surveys will not be necessary for the other project lines, since the background file on the application for financing contains all the basic information needed to measure the impact of the corresponding project. The cost of the final evaluation is an estimated US\$700,000.

### C. Scale

- 2.37 Three aspects have been considered in scaling the program: the existing pipeline of projects, FONCODES' institutional capacity to execute it and the availability of the counterpart. The pipeline includes 2,250 projects costing about US\$60 million that have already received positive evaluations. As for institutional capacity, FONCODES financed almost 6,000 projects a year during stage two, which is more than will be required in the new stage. The counterpart will be assured if the World Bank cofinancing, described later, is taken into consideration.

### D. Cost and financing

- 2.38 The program will cost a total of US\$187.5 million, with the Bank financing US\$150 million (80 percent) and the country US\$37.5 million (20 percent). The administration category only includes the cost of consulting services to provide support, since staff are financed by the government with funds that do not form part of the program.

**Table II-1**  
**Cost distribution**  
**(US\$ thousands)**

CATEGORY	IDB		LOCAL		TOTAL	
	US\$	%	US\$	%	US\$	%
<b>I. ADMINISTRATION</b>	<b>600</b>				<b>600</b>	<b>0.3%</b>
1.1 Consulting services	600		-		600	
<b>II. INVESTMENT</b>	<b>139,500</b>	<b>93.0%</b>	<b>33,900</b>	<b>90.4%</b>	<b>173,400</b>	<b>92.5%</b>
2.1 Social and economic infrastructure	87,700		27,900		115,600	
2.1.1 Financing for works	80,000		27,900		107,900	
2.1.2 Financing for community training	7,700				7,700	
2.2 Consolidation of rural REDs	21,000		-		21,000	
2.3 Rehabilitation of social and economic infrastructure	30,800		6,000		36,800	
<b>III. TRAINING &amp; STRENGTHENING</b>	<b>4,050</b>	<b>2.7%</b>	<b>3,600</b>	<b>9.6%</b>	<b>7,650</b>	<b>4.1%</b>
3.1 Initial promotion			2,800		2,800	
3.3 Training for FONCODES			800		800	
3.4 Computer equipment	1,900		-		1,900	
3.5 Training in social management – INDES	1,750		-		1,750	
3.6 Implementation of the environmental management plan	400		-		400	
<b>IV. FOLLOW-UP, EVALUATIONS AND AUDITS</b>	<b>3,350</b>	<b>2.2%</b>	<b>-</b>	<b>-</b>	<b>3,350</b>	<b>1.8%</b>
4.1 Preparation of the baseline (design and surveys)	190		-		190	
4.2 External monitoring	1,100		-		1,100	
4.3 Mid-term evaluation	160		-		160	

**Table II-1**  
**Cost distribution**  
**(US\$ thousands)**

CATEGORY	IDB		LOCAL		TOTAL	
	US\$	%	US\$	%	US\$	%
4.4 Final evaluation	700		-		700	
4.5 External auditing	1,200		-		1,200	
<b>V. CONTINGENCIES (0.5%)</b>	<b>1,000</b>	<b>0.7%</b>	<b>-</b>	<b>0.0%</b>	<b>1,000</b>	<b>0.5%</b>
<b>VI. I&amp;S</b>	<b>1,500</b>	<b>1.0%</b>	<b>-</b>	<b>-</b>	<b>1,500</b>	<b>0.8%</b>
<b>TOTAL US\$</b>	<b>150,000</b>	<b>100%</b>	<b>37,500</b>	<b>100.0%</b>	<b>187,500</b>	<b>100.0%</b>
<b>%</b>	<b>80</b>		<b>20</b>			<b>100</b>

- 2.39 The commitment period will be 3.5 years and the disbursement period will be four years. The following table summarizes the terms and conditions of the loan.

**Table II.2**  
**Terms and conditions of the loan**

Amortization period	25 years
Commitment period	3.5 years
Disbursement period	4 years
Interest rate	Variable
Inspection and supervision	1%
Commitment fee	0.75%
Currency	U.S. dollar, Single Currency Facility

## **E. Cofinancing**

- 2.40 The Peruvian government and the World Bank are negotiating a loan of US\$52.5 million for a rural education program. Under that program, FONCODES will execute a school-rehabilitation component for US\$22,250,000, with US\$10,060,000 coming from the World Bank loan and US\$12,190,000 from projects financed under the IDB loan presented in this document.
- 2.41 These conditions comply with the requisites for parallel cofinancing between the two banks. The IDB allows cofinancing of this kind to be recognized from the national counterpart. A similar agreement for the PRONASAR is under negotiation but the negotiations are not sufficiently advanced to be included in this proposal.

### **III. PROGRAM EXECUTION**

#### **A. The borrower, guarantor and executing agency**

- 3.1 The Government of Peru will be the borrower and the program will be executed by FONCODES. Presentation to the Bank of the resource carry-over agreement between the government and FONCODES to transfer the loan proceeds to the Fund will be a condition precedent to the first disbursement.

#### **B. Executing agency**

- 3.2 FONCODES has a simple organizational structure and its actions are decided on by a five-person board of directors appointed by the president of Peru. The board of directors defines policies, regulates and supervises the general operation of the institution and approves projects costing more than US\$100,000 equivalent. One of the members of the board acts as executive director, who is the Fund's legal representative and is in charge of implementing the board's decisions. FONCODES' structure since April 2001 includes seven management offices and 14 sub-management offices that report to the executive director. The General Manager's Office controls and supervises the actions of the line offices and the institutional support offices. FONCODES also has a decentralized structure composed of 24 zone offices, each headed by a zone chief. It has a staff of 294 technicians, with 145 at headquarters and 149 at the zone offices. The cost of its staff is paid by the Peruvian government and is not financed with program resources.
- 3.3 This structure is being adjusted to adapt it to the new requirements of the program and of the government's modernization and decentralization processes. The structural adjustments under consideration include: (i) the formal incorporation of the Commission on Transparency, Ethics and Institutional Integrity (CTI) as a unit that reports to the board of directors of the organization, confirming its make-up which includes representatives of the Public Ombudsman, the Anti-Corruption Committee and the College of Engineers; and (ii) the establishment, within the context of the modernization and decentralization process, of a local investment fund or its equivalent that eliminates duplication and optimizes the use of the resources of the different activities of existing social funds or programs. Approval by the board of directors of the formal inclusion of the CTI as a unit that reports to it will be a condition precedent to the first disbursement.
- 3.4 To maintain the institution's high technical level, an agreement has been reached to ensure greater continuity in professional and managerial positions at headquarters and in the zone offices (ZOs). Where it is necessary to make changes or hire new technical or managerial staff, FONCODES will hold public competitions to fill the vacancies. The Bank's nonobjection to the terms of reference for these competitions


and the technical profiles of candidates must be obtained prior to publishing the announcements. If this process is not complied with at any ZO, the funds committed by that office will not be included in the program, after the event occurs. This obligation will be included in the loan contract.

## C. Project cycle

### 1. Investment components

- 3.5 **Project cycle for infrastructure subcomponents.** The lessons learned from the previous stages have been drawn on, particularly with respect to promotion and training and the need for coordination and linkage with other local entities to achieve greater project sustainability. Broadly speaking, the project cycle is divided into three phases: (i) preinvestment, (ii) execution, and (iii) monitoring. Each phase includes a series of steps and activities that are carried out jointly by the communities, the technical and social agents, the municipality, the coordination bodies and FONCODES.
- 3.6 FONCODES is the financial and supervisory body and the executing units (EUs) prioritize and execute the projects. These EUs are elected at community meetings and are required to comply with certain rules to ensure their legitimacy. In the present stage, the EUs will have a new advisor representing the municipality. The advisor will be elected by the community from a short list prepared by the mayor. The coordination bodies, composed of representatives of the communities and public and private local institutions have the task of harmonizing the projects with local development plans. The municipality plays an oversight and/or cofinancing role in execution of the works and, when necessary, is responsible for maintaining them. FONCODES will contract individuals or firms for project evaluation and supervision and operators to carry out the work of promotion, community training and development of capacity in the EUs and the management committees. The EUs will also contract individuals or firms to prepare the projects and provide technical direction for the works.
- 3.7 **Focus.** To determine the districts where it will act, FONCODES uses the poverty map, which identifies passable, poor, very poor, and extremely poor districts, giving priority to the last three. It then preassigns resources on the district level. To determine the localities in each district, FONCODES uses the services of promoters to hold meetings with district coordination bodies, that include community representatives, municipal authorities and representatives of civil society organizations and together they identify priority localities for project financing.
- 3.8 **Preinvestment.** This stage begins with promotion in each of the targeted localities to enable the community to identify its projects, prioritize them, establish its EU and apply for funding. Next, FONCODES evaluates the technical feasibility of the applications and ranks them in order of priority by running them through a

computer program that uses multivariable criteria and, if warranted, proceeds to grant preinvestment financing. The project's technical file is evaluated and submitted for approval to the zone office's approvals committee.

- 3.9 **Execution.** Once a project is approved, the EU signs a financing agreement with FONCODES and proceeds to carry it out, with the resident inspector of the ZO providing advisory services. Technical training is provided for the management committees that will be responsible for operating and maintaining the works and community training is provided for the beneficiaries. During the project, the EU presents a monthly balance sheet on the investments to the community and FONCODES. At the end of the project, the EU presents the final settlement prior to signature of the project completion certificate, which is approved by FONCODES, and the works are transferred to the management committee.
- 3.10 **Monitoring.** To ensure project sustainability, FONCODES will monitor the management committees, through an operator, for eighteen months. The operator will pay periodic visits, depending on the type of project, to evaluate  strengthen management capacity. The operator will also promote coordination with the municipality and the education, health, agriculture and other sectors, in order to link up actions to boost operating and maintenance capacity. At the end of this stage, an evaluation will be performed of community management in operating and maintaining the project.
- 3.11 **Project cycle for the RED consolidation subcomponent.** The cycle for projects to consolidate REDs basically have the same stages, with certain special features. The actions will focus on the 11 socioeconomic micro-corridors identified in the previous stage. Promotion will take place on two levels: (i) with public and private institutions that promote rural business to identify possibilities for linkage and partnerships; and (ii) with the target population, providing information and raising awareness to obtain their active participation as direct users of the program. After the promotion, groups or communities will present a profile of their business plans, applying to FONCODES for financing of the training necessary for their execution. The profile is presented to zone office, which will establish an evaluation and prioritization committee, composed of two ZO professionals and a representative of the committee responsible for coordination with other complementary institutions. The evaluation and prioritization should establish scenarios for possible linkages and a cost estimate.
- 3.12 The communities with prioritized profiles will elect their EUs at community meetings. Associations of five or six EUs at a meeting of all their members will establish a central executing unit (CEU) that will sign an agreement with FONCODES to contract the consultants who will prepare the projects for each community, including the business plans and actions necessary to consolidate the productive and organizational processes of the target population. The project is then presented to the ZO, which evaluates it and, if approved, establishes an execution

timetable and disbursement schedule. Each EU is responsible for carrying out the activities planned for its community, and some functions are delegated to the CEU to ensure economies of scale in contracting and project administration. The ZOs will make available a register of suppliers who can be contracted by the CEU for the capacity-building activities in each project. The register will include NGOs, professional services centers or independent firms accredited for these tasks. The particulars of the registers, terms and conditions of contracting and payment are described in the Operating Regulations.

- 3.13 Last, FONCODES will verify good project execution through supervisors who will examine in the field the execution of all project activities and contents. After the project is completed, the EU will present the final settlement to the ZO, which will review it and, if it is approved, will wind up the project.

## **2. Social infrastructure rehabilitation component**

- 3.14 **Project cycle for the infrastructure rehabilitation component.** The phases in the project cycle are similar to those described above, with the difference that the projects include various works to be rehabilitated. They also provide the immediate benefit of temporary employment. The process begins when the inhabitants of the localities in the targeted districts, supported by a promoter contracted by FONCODES, perform an analysis and prioritization of their needs. Local meetings are then held to elect their delegates, agree on the work schedule and draw the names of candidates for the work brigades. Community priorities are written down in the records of the meetings, which are presented to the coordination body. After consolidating the records of the meetings in all the localities, they are presented at a workshop promoted by the zone office, also attended by representatives of the district municipality, the community and FONCODES. The workshop prioritizes the infrastructure to be rehabilitated or the activities to be performed. All the localities hold a general meeting in which the delegates participate and elect the EU, which will include a advisor proposed by the municipality.
- 3.15 Once the technical file on the project is ready, it is presented to the ZO for evaluation and submission to FONCODES' zone approvals committee. The financing agreement for the project is signed by the FONCODES zone chief, the EU's president, secretary, treasurer, and municipal advisor and the technical and administrative inspectors contracted by the EU.
- 3.16 The EU executes the project through the work brigade, according to the approved plan. On-going training is provided for the brigade by the construction foreman, who acts as instructor. The project and zone supervisors are responsible for works supervision. Municipal supervision is the responsibility of the municipal advisor.
- 3.17 The supervisor verifies that the work has been performed in accordance with the technical file and signs the project completion record. Last, the EU and the

inspectors present the final settlement, which is reviewed by the zone supervisor and the FONCODES reviewer, who verify it and process its approval, issuing the corresponding project completion certificate.

### **3. Capacity-building and training component**

- 3.18 **Community training.** Training and technical assistance for the communities will be contracted out. FONCODES will determine the content of the technical assistance and the standards for the services to be contracted, provide the materials to be used in the training and contract and supervise the service suppliers, which may be universities, NGOs, consulting firms or individual consultants.
- 3.19 To begin executing this component, FONCODES will contract the services of an organization (university, NGO or consulting firm) to: (i) prequalify institutions that could potentially provide services, based on institutional capacity, experience in social development in rural areas and permanent or temporary personnel to cover the different subject areas; (ii) instruct the prequalified organizations in the objectives and contents of the training they will offer; and (iii) certify eligible entities to carry out the training and technical assistance activities for communities.
- 3.20 FONCODES will prepare terms of reference and an official budget that includes all the training activities envisaged for a set of communities. It will also prepare a price list per zone for variable items such as per diems and travel costs. The TOR will include: (i) technical training in administration, operation and maintenance of the works, particularly potable water, sanitation and road works; (ii) training and strengthening of communities in community and organizational management, gender equity and environmental conservation; and (iii) for potable water and sanitation projects, monitoring of the management committee and the community for a period of 18 months.
- 3.21 The ZOs will establish registers of trainers and operators and will invite certified entities interested in providing services to register. Based on the register, it will hold a competition to deliver the training in all or part of its jurisdiction. The competitions will be decentralized and the contracts will be awarded by special awards committees that will operate in each ZO, which will include a representative from each beneficiary EU.
- 3.22 **Training for FONCODES.** Management and technical training for FONCODES staff will be contracted with public or private academic institutions. Activities that are carried out individually—such as attending special courses—may be financed, upon presentation and approval of the respective training program or plan by the FONCODES unit in charge.
- 3.23 **Training in social management.** This subcomponent will be executed by the Inter-American Institute for Social Development (INDES), which, apart from bearing

basic responsibility and managing the resources, will bear technical responsibility for its design and development, with the cooperation of FONCODES' teams. The program will last for two years and be national in coverage. INDES will identify consultants to be contracted for coordination, teaching and supervision. INDES may reach agreements with universities or training institutions to execute or prepare certain training-related activities, but will retain technical responsibility for them.

**D. Contribution by the beneficiaries and the municipalities**

- 3.24 The contribution of unskilled labor will represent a minimum of 10 percent of the labor required by the project, except for sanitation projects, where the beneficiaries will provide 100 percent. To ensure suitable management and control of these contributions, FONCODES will include them in the project's budget as part of the cost, for evaluation purposes. These contributions can be recognized as part of the local counterpart, up to the equivalent of US\$1.8 million (5 percent of the counterpart) but may not exceed 10 percent of the counterpart per project. The contributions will be monitored during the project to determine whether any differences exist between the unskilled labor contribution established in the project and the real contribution by the end of the project. Where the municipalities provide cofinancing, as is planned for the potable water and road projects, for example, that cofinancing may also be considered part of the local contribution.

**E. Transparency**

- 3.25 FONCODES has established a Transparency, Ethics and Institutional Integrity Committee to maintain and enhance the high degree of trust and credibility it enjoys among beneficiaries, civil society and the organizations that support its financing. The committee is composed of a representative of FONCODES, who chairs it, a representative from each line unit, a representative of the coordination committee for the struggle against poverty, a representative of the College of Engineers and a representative from the Office of the Public Ombudsman. At present, it is an advisory unit to executive director. Under the institutional adjustment, it will become a unit that reports to FONCODES' board of directors. The unit will complement the work of the Internal Audit Office, by promoting ethics and institutional integrity.
- 3.26 The committee's work will be included on FONCODES' web page. A portal is being designed that will permit the publication of background and costs for all the projects financed by FONCODES. The system is required to be operational as a condition precedent to the first disbursement.

**F. Institutional coordination**

- 3.27 One of the main lessons learned is the need for close coordination with public and private institutions that work in the social sector to ensure that FONCODES'



interventions reflect sector policies and comply with technical standards and directives. A series of measures has been planned for good coordination, including: (i) the signature or ratification, where they exist, of inter-agency agreements with ministries of health; education; housing, construction and sanitation; and transportation and communications, spelling out mutual obligations; (ii) coordination with the municipalities and local institutions during the project cycle to avoid duplication of activities; (iii) participation by a representative of the municipality in the executing unit to provide linkage with local and community institutions; and (iv) before the financing agreements are signed for the projects, the receiver and operator of the work will be identified and its agreement it will be obtained to receive and operate it. The signature or ratification of agreements, to the Bank's satisfaction, will be a condition precedent to the first disbursement.

#### **G. Operating Regulations**

- 3.28 The program will be governed by the Operating Regulations, composed of a main body that contains general eligibility criteria and specific guidelines for each type of work or activity and their respective eligibility criteria. The Operating Regulations contain the rules, procedures and regulations needed to execute each of the program's components, and the establish functions and obligations of the different players involved in execution. The specific guidelines for each sector contain cost-efficiency indicators for each type of project. The general eligibility criteria include: (i) the beneficiary population must live in a locality in a district classified as poor; (ii) the cost of the projects may not exceed US\$250,000 equivalent; (iii) the projects must be in one of the program's lines of investment and include components to ensure their operation and maintenance; (iv) the projects may not have a negative environmental impact or have impacts that cannot be mitigated at a reasonable cost; (v) the projects may not be located in sensitive or fragile ecosystems; (vi) the projects must respond to an express public need and have been asked for by the target community; and (vii) the projects must comply with all the provisions of the agreements reached with sector entities, particularly for sanitation and rural roads. These agreements will form part of the Operating Regulations. The program's operating guides and manuals will establish specific criteria, including rules for environmental protection, that must be complied with to be eligible for program financing. The Operating Regulations were presented to the Bank, which must approve them before they are placed in effect, which will be a condition precedent to the first disbursement, and any changes to them will be made in agreement with the Bank.

#### **H. Financial administration**

- 3.29 FONCODES will be responsible for: (i) opening specific, separate bank accounts for program funds; (ii) presenting disbursement requests and justifications of expenditures to the Bank; (iii) maintaining suitable systems for contract administration and accounting and financial records of transactions; (iv) preparing

and presenting the consolidated financial statements of the program, including the semiannual auditor's reports on operational and financial considerations and other financial reports required by the Bank; and (v) transferring funds to the executing units, in accordance with the conditions established in the Operating Regulations.

- 3.30 The executing units will be responsible for: (i) keeping separate, specific accounts for program funds; (ii) keeping suitable records; (iii) accounting to FONCODES for the use of program funds; and (iv) preparing and providing the financial information required by FONCODES.
- 3.31 The use of all program funds will be subject to Bank rules and policies and to the procedures and guidelines stipulated in the Operating Regulations. Detailed accounts of all expenditures and cost recognition will be kept for each project financed by FONCODES and consolidated accounts will be kept for the program as a whole. Separate records will be kept for accounting and justification of advances of funds, including a detailed table of payments made during each period, which is to be attached to disbursement requests and justifications for advances of funds.
- 3.32 Considering that this is a decentralized project that includes many small works spread around the country, replenishments and/or justifications for the revolving fund will be based on the supporting documentation for transfers of funds to the executing units. Ex post reviews will be made of a sample of expenditures and disbursements, through semiannual external audits performed at FONCODES' zone offices and the EUs. Notwithstanding that, FONCODES will be required to demonstrate to the Bank the extent to which the EUs have justified the advances they received in the successive replenishments of the revolving fund. A more detailed description of the specific procedures for control over expenditures is contained in the Operating Regulations.
- 3.33 In addition, FONCODES will present quarterly statements of settlement for the advances transferred to the EUs, based on the payments actually made by them. The detailed procedure and content of the statements of settlement are presented in the Operating Regulations.
- 3.34 FONCODES will keep records and full files on each operation that has generated an expenditure. The EUs will also keep separate records and files for their operations. All the supporting documentation, such as the project evaluations, the summary fiches, receipts, reports, supervision reports, etc., will be duly filed by FONCODES and by the EUs, to the Bank's satisfaction and will be placed at its disposal and at the disposal of the external auditors for review.

## **I. Procurement**

- 3.35 Standard Bank procedures will be followed in the procurement of goods and services and in the award of contracts for program works. International competitive

bidding will be used for goods and services worth US\$250,000 and over. Although no major works are planned, international competitive bidding will be used whenever the cost is above US\$1 million. When the works are under US\$90,000, they will be executed on force account by the executing unit, which is permitted in Peruvian legislation, and the procedures are included in the respective FONCODES manuals. Nonetheless, it is recommended that national procedures be followed for their award, provided they do not conflict with Bank policies. International competitive bidding will be used for consulting services costing US\$200,000 and over. In all other cases, the Bank procedures included in Annex C of the loan contract will be followed. The procurement plan is attached as Annex III-1.

**J. Estimated disbursement schedule**

- 3.36 The disbursement schedule presented in Table III-1 takes account of financing for existing demand for the Fund and the availability of counterpart resources.

**Table III-1**  
**Estimated disbursement schedule**

Source	Year 1	Year 2	Year 3	Year 4	Total
IDB	50,000	45,000	35,000	20,000	150,000
Local	6,000	9,000	11,000	11,500	37,500
Total	56,000	54,000	46,000	31,500	187,500
%	29.9%	28.8%	24.5%	16.8%	100%

**K. Cost recognition and revolving fund**

- 3.37 To facilitate the continuity of FONCODES operations, it is proposed that the program recognize retroactive spending of up to US\$8 million on activities carried out by the Fund during the 12 months prior to approval of the loan to prepare the program and to finance the investment component. Up to US\$2 million will be recognized from the local counterpart for spending on the same items during the 18 months prior to approval of the loan. These costs will only be recognized if procedures similar to those that will be used during the program were followed. Considering the expected pace of execution, it is recommended that a revolving fund of up to 5 percent of the loan proceeds be established.

**L. External auditing**

- 3.38 The program and FONCODES will be externally audited by an independent firm of auditors acceptable to the Bank. The audits will be performed in accordance with terms of reference approved by the Bank (document AF-400). The firm will be

selected and contracted following the standard bid process for auditing firms defined by the Bank (document AF-200). The auditing costs have been included in the cost of the program and will be financed with proceeds from the Bank's loan. The auditing firm will be contracted by the executing agency for a minimum of three years, subject to a termination clause in the event that the Bank finds its performance to be unsatisfactory. The financial statements of the program and FONCODES will be presented within 120 days after the close of the fiscal year. The executing agency will also present the Bank with an auditor's report on the operational and financial aspects of the program within 60 days after the end of each semiannual period. This report is an extension of the work of the same firm that performs the external audit of the program, subject to terms of reference approved by the Bank, which will include visits to the zone offices and executing units and reviews by sampling. The semiannual reports will include the auditor's opinion on the disbursement requests and their supporting documentation, in accordance with the terms of reference for ex post reviews of disbursements (document AF-500).

- 3.39 The external audit for 2000 contained some reservations regarding internal controls in FONCODES, which required improvement. The most important were: (i) the Control and Methods Unit should centralize and monitor the procedures used; (ii) there was no operations manual that integrated all the areas; (iii) there was no accounting manual or auxiliary records for the analysis of accounts or a manual for the logistics area; and (iv) the selection of consultants did not comply with Bank requirements. During 2001, FONCODES began taking steps to respond to these objections and corrective measures for problems that were still pending were taken during preparation of the proposed program. All the reservations have been addressed.
- 3.40 **Ex post evaluation.** The country does not plan to finance an ex post evaluation of the program. However, the information compiled for the annual follow-up meetings and the mid-term and final evaluations will include indicators that would permit an ex post evaluation to be conducted should the Bank decide to perform one.

**M. Progress reports and follow-up meetings**

- 3.41 FONCODES will present semiannual reports to the Bank during the program, with a breakdown of the works financed, the beneficiaries assisted and the operating procedures used to execute the program. These reports will be presented within 60 days after the end of each semiannual period.
- 3.42 Follow-up meetings will be held between FONCODES and the Bank at least once a year. Donors working with FONCODES will be invited to attend the meetings to review, *inter alia*, the operation of the program, progress in the institutional changes envisaged, reports by the firm hired to monitor the program and progress in other projects financed under bilateral agreements. The first of these meetings will

be held when the conditions precedent are complied with, and will serve as the workshop launching the program.

## IV. FEASIBILITY AND RISKS

### A. Feasibility

- 4.1 **Financial feasibility.** The program's scale is compatible with FONCODES' capacity, based on its history in the earlier stages. The institutional strengthening component for the Fund, its professional team for program administration, and the experience gained from other operations with external funding ensure that execution will be efficient. Also, in this third stage, support from specialized entities in relevant areas such as training and technical assistance will be available under contracts with outside institutions. A sufficient number of specialized entities with considerable working experience in rural areas and suitable permanent or temporary professional teams are available to carry out activities of this kind.
- 4.2 Stage three of FONCODES will be carried out in a context of reforms, supported by the Bank through two fiscal reform sector loans (PE-0211), which aim to improve the sustainability of present levels of public spending and will contribute to the fiscal sustainability of the FONCODES III program. The aim of these fiscal reform actions is to improve the efficiency and equity of the tax system, helping to restore the collection levels seen in the mid 1990s. At the same time, these actions support the streamlining of public spending and include a list of priority social programs (that FONCODES considers), spending for which has been protected during the recent recessionary period. This list for the protection of priority social spending during periods of crisis will be maintained as a tool of fiscal policy during future periods of extended recession. Likewise, policies and mechanisms are being implemented to target spending on the poorest populations. Given its design and objectives, FONCODES is one of the best focused social programs. These measures ensure that FONCODES will continue to play a key role in social policy, with adequate financing.
- 4.3 **Technical feasibility.** The technical feasibility of the projects is assured, since their design follows the technical guidelines established by the different sector ministries or other specialized institutions. The potable water and rural education programs financed by the World Bank and the rural roads program financed by the IDB should be mentioned in particular. A strategy has been agreed upon whereby all the water and school works executed by FONCODES will be governed by common rules and procedures, coordinated and supervised by the respective line ministries. FONCODES will not finance roads in areas where the IDB's PCR is operating. In areas where it is not active, the works financed by the Fund will use the same means of execution, operation and maintenance as are used in the PCR and will be supervised by the pertinent ministry. The strategy for consolidating the REDs is based on close coordination with other public agencies, such as the Ministry of Agriculture, and private agencies, such as microlending institutions, which will bring specialization and experience to each stage of the projects to be financed.

Technical feasibility will also be consolidated by building capacity in the community, through monitoring and technical assistance after the works are completed to support their sustainability.

- 4.4 **Economic feasibility.** During the earlier stages of FONCODES, criteria and indicators were prepared to establish cost-efficiency ranges for each of the types of projects to be financed. The evaluations found that the methodology used to design the indicators was appropriate. These indicators will continue to be used in evaluating the projects to be financed in the new stage.

## **B. Social review**

### **1. Impact on poverty**

- 4.5 Given the program's nature and objectives, it forms part of the poverty-reduction strategy established in the Eighth General Increase in the Resources of the Bank, since the investments are focused on rural communities in the poorest and remotest parts of the country. The focus achieved in the previous stage meant that 66.3 percent of the beneficiaries were extremely poor communities and 30.8 percent were poor. Just 3 percent of the beneficiaries were nonpoor communities. In this stage, use of the same focusing systems—the poverty map and information systems with multivariable indicators—will make it possible to achieve similar results.

### **2. Gender equity**

- 4.6 The evaluations indicate that women have played a prominent role in the executing units. However, in the new stage, actions have been included to boost their participation in all stages of the project cycle, with greater stress on project identification, preparation and execution. Participation by women in the training to boost organizational and management capacity will be promoted. Existing training instruments have been reviewed and adjusted and the preparation of additional instruments is being considered. FONCODES technical staff at headquarters and the zone offices and the communities will continue to be sensitized to the importance and benefits of applying a gender approach. Existing materials will be adjusted and specific modules will be prepared for this activity.
- 4.7 In short, the program will continue to facilitate participation by women and will promote their increased inclusion in the executing units and in project management and administration committees and the potable water and roads committees. In particular, support will be given to actions to consolidate a culture of gender equity.

### **3. Participation by native communities**

- 4.8 The indigenous population in the sierra, coast and jungle numbers almost 8.8 million people out of a total population of 26.8 million, i.e. indigenous people make up 33 percent of the population. Between 1991 and 2001, FONCODES

financed 35,378 social and economic infrastructure projects, with 19,752 of them directly benefiting indigenous communities (see paragraphs 1.19 and 1.20). In other words, although they account for 33 percent of the population, these communities received 56 percent of the FONCODES projects.

- 4.9 Considering that each ethnic community differs in key aspects, the program establishes a strategy that provides a suitable response to their specific conditions and needs, particularly for communities on the coast and in the Amazon. Ethnoengineering instruments will be used to seek alternatives that will improve the quality of Fund interventions and lend support to the maintenance and sustainability of the works. To contribute to empowerment, actions will be included such as use of the native tongue and the strengthening of organizational levels in the traditional ancestral sphere and in ethnic policy. The common themes present in training will take account of the principles of equity, gender and environmental protection.
- 4.10 **Commission for Andean, Amazon and Afro-Peruvian Peoples (CONAPAAA).** Last, to support FONCODES in its work with Afro-Peruvian and Amazon indigenous communities, an agreement has been reached with CONAPAAA whereby the commission will promote social and economic infrastructure projects for the equivalent of up to US\$5 million. The projects, which will have to comply with program eligibility requirements, will be presented to FONCODES for evaluation and financing.

### **C. Environmental impact**

- 4.11 FONCODES has included the environment among its priorities since 1996 and has made significant progress, which led to the design of a methodology that was embodied in an environmental impact assessment guide for social projects. However, the environmental audit conducted by RE3, while recognizing the major effort made by FONCODES in environmental protection, identifies certain aspects that need to be improved, such as the application of the environmental assessment guides and operating manuals and the system for classifying projects on the basis of their environmental risks, monitoring the application of mitigation measures, and training for FONCODES staff and the executing units in environmental management. The audit suggests options for solving these problems. It also recommends that the mid-term and final evaluations include environmental management considerations.
- 4.12 Based on the audit's recommendations, FONCODES has begun to revise its environmental impact assessment guides and manuals, keeping the following aspects in mind, among others: (i) simplification of the language and procedures; (ii) diversification based on the main ecosystems (sierra, coast and jungle); and (iii) adaptation to the cultural diversity of those areas. It is also considering ethnoengineering principles for the identification, prioritization, design and



execution of the projects, based on cultural identity, participative methods and a renewed appreciation of local materials.

- 4.13 In the institutional aspect, FONCODES currently has one specialist in charge of environmental management, but a single employee is unable to cover all the tasks. For FONCODES III, as part of the institutional reengineering process, an environmental unit will be included in the infrastructure management area. Also, with a view to strengthening this institutional aspect, coordination will be established to have FONCODES' environmental work included in the national environment system. Contact has been made with the National Environment Council (CONAM), the country's lead agency in environmental policy, and with other entities such as the National Natural Resources Institute (INRENA) of the Ministry of Agriculture, the Directorate General of Environmental Health of the Ministry of Health, and the Environmental Directorates of the Ministries of Transportation and Communications and Energy and Mines, to establish agreements to be signed in the first quarter of 2003, whereby these agencies will include environmental evaluations of FONCODES projects in their procedures, as is required by law.
- 4.14 FONCODES has been promoting sensitization to environmental protection, particularly among the beneficiaries of potable water and sanitation projects. In this new stage, it will reinforce those activities during the initial promotion, extending them to all the project lines it finances. The use of natural resources in the different regions and hygiene and health standards have been included in the content of the training courses.
- 4.15 Last, the projects will obtain environmental certification from the authorities, as established in Law 27446 of April 2001 on Environmental Impact Assessment. The enabling regulations are expected to be published in the last quarter of 2002. Notwithstanding, the possibility of introducing voluntary certification (ISO 14000 or ISO 9001) will be studied with a view to providing value added for certain products, such as coffee, honey, alpaca hides, cotton and others.
- 4.16 To ensure the environmental feasibility of the operation, the program's cost table includes a subcategory for financing the environmental management plan for US\$400,000, which based on is a study of the estimated cost of implementing all the measures described.

#### **D. Benefits**

- 4.17 The program will directly benefit poor rural communities by financing: (i) approximately 4,325 small projects to improve the quality of life in a similar number of communities, by promoting the use of education, health, potable water, sanitation, electricity and basic road services; and (ii) training in activities that will

permit beneficiaries to improve their incomes and make better use of the services provided.

- 4.18 Social participation, which is a priority in the plans to decentralize and modernize the State, will be facilitated by the methodology used in the program, based on executing units. The methodology, which was used and evaluated in the two previous stages, will be strengthened in this third stage, by including a municipal representative in each unit, which will provide the representative with first-hand knowledge of the communities and their priority projects. This methodology allows the communities to participate more fully in prioritizing the works in function of their own needs and demands, contributing to their empowerment. Also, transparency in the use of resources by the community is strengthened since it is the community that elects the members of the executing unit, which will report continuously at community meetings.
- 4.19 By consolidating the strategic development clusters (REDs), the program is embarking on a path toward the sustainable improvement of rural communities that have development potential but have been unable to capitalize on it owing to the lack of training and basic support. This is a process that the program will support as the centerpiece of coordinated action with other public and private agencies, optimizing the use of resources and achieving greater synergy in these actions.
- 4.20 Last, the program will support the institutional development of FONCODES in function of government guidelines that seek to consolidate work in the social sector to avoid duplication of activities, overcome the lack of institutional coordination in the country and, in general, make better use of the internal and external resources spent on the social sector.

#### **E. Risks**

- 4.21 **Personnel policy.** One potential risk is that management and professional positions might be filled with unqualified staff, losing the know-how and experience built up over the Fund's 10 years of existence. **Mitigating measure.** To maintain the Fund's high technical level, an agreement has been reached to ensure greater continuity in professional and managerial positions at headquarters and in the zone offices (ZOs). Where it is necessary to make changes or hire new technical or managerial staff, FONCODES will hold public competitions to fill the vacancies. The terms of reference for these competitions and the technical profiles of candidates will be agreed upon with the Bank prior to publishing the announcement. If this process is not complied with at any ZO, the funds committed by that office will not be included in the program, after the event occurs. These obligations will be included in the loan contract.
- 4.22 **Transparency and politicization.** Another risk refers to politicization and transparency in the allocation of resources. **Mitigating measure.** To mitigate this

risk, apart from the rules and regulations governing program execution, FONCODES has established a Commission on Transparency, Ethics and Institutional Integrity (CTI), whose members are drawn from the Committee to coordinate the fight against poverty, the College of Engineers, the Office of the Public Ombudsman and other bodies. The committee will be treated as a unit that reports directly to FONCODES' board of directors. By promoting ethics and institutional integrity, this unit will complement the work of the Office of the Internal Auditor, which oversees the legality of procedures and the proper use of resources. In addition, reports on the committee's actions will be posted on FONCODES' web page and a portal is being designed that will include information about all projects financed by the Fund and their cost.

- 4.23 **Institutional framework.** Another risk is that the plan to decentralize and modernize the State that the country will carry out, under which FONCODES will play a relevant role in the social area, could be delayed or suffer distortions during implementation, which would affect the program. **Mitigating measure.** A mid-term evaluation will be performed to measure operational effectiveness and determine whether FONCODES has successfully integrated into the central government's reorganization and decentralization process. The evaluation will review compliance with the following: (i) FONCODES has been institutionally integrated into the ministry of human and social development or its equivalent; (ii) the Local Investment Fund has been created by merging the different funds that are currently operating in the social sector and regulations for the Fund have been approved; and (iii) a role with respect to the local governments has been defined and assigned to FONCODES, consistent with the new decentralization strategy. The above will be a special condition in the loan contract.
- 4.24 **Municipal weakness.** Another risk is the weakness in human and financial resources exhibited by the municipalities where FONCODES is active. This has a special impact on the process of transferring responsibilities included in the decentralization plan. **Mitigating measure.** The program will include in the most critical projects—such as drinking water projects—funds to finance monitoring after completion of the works. Specialized institutions will be contracted to perform the monitoring, which will last for about 18 months (see the section on community training).

**LOGICAL FRAMEWORK**  
**STAGE THREE OF THE PROGRAM TO SUPPORT THE NATIONAL COMPENSATION AND SOCIAL DEVELOPMENT FUND**  
**FONCODES III (PE-0193)**

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<b>OBJECTIVE</b>			
To help improve the quality of life of the poor living in remote rural areas.	Quality of life indicators such as access to and coverage of basic needs and income levels in rural areas improve.	Household surveys	<ul style="list-style-type: none"> <li>The country's economic situation remains stable or improves.</li> <li>Processes of modernization and decentralization of the State are consolidated.</li> </ul>
<b>PURPOSE</b>			
1. The poor rural population, who are program beneficiaries, are connected to the network of basic social services; producers improve their economic situation and capacity for sustainable productive development; and women play a larger role in the executing units.	<p>1.1 By the end of the program, diarrhea in children five years of age and under is reduced by 20% compared to the base year, in households connected to water and sanitation systems.</p> <p>1.2 By the end of the program, at least 85% of the works are operating in a sustainable manner and observe environmental conservation guidelines.</p> <p>1.3 By the end of the program, the beneficiary population has increased its production by 20% and its income by 15%.</p>	<p>1.1.1 FONCODES information system</p> <p>1.2.1 FONCODES information system and the final evaluation</p> <p>1.3.1 Follow-up reports and the final evaluation</p>	<ul style="list-style-type: none"> <li>The agencies in charge have allocated funds to operate and maintain the works.</li> <li>No natural disasters or extreme weather events occur.</li> <li>The prices of farm produce remain stable.</li> </ul>

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
	<p>1.4 By the end of the program, at least 90% of the communities that received training submit basic social infrastructure projects that meet the financing criteria.</p> <p>1.5 At least 40% of the members of the executing units are women by the end of the program.</p>	<p>1.4.1 Follow-up reports and the final evaluation</p> <p>1.5.1 Follow-up reports, surveys and the final evaluation</p>	<ul style="list-style-type: none"> <li>The funds committed for operation and maintenance are transferred on time.</li> </ul>
<b>COMPONENTS</b>			
<p>1. Projects for basic social infrastructure, economic infrastructure, creation of productive capacity and rehabilitation of works have been financed, executed and are operating.</p>	<p>1.1 By the end of the program, 4,325 projects have been financed in poor rural areas.</p> <p>1.2 By the end of the program, 2,785 social and economic infrastructure projects have been financed and are operating.</p> <p>1.3 By the end of the program, 880 projects in the economic corridors have been financed.</p> <p>1.4 By the end of the program, 660 projects to rehabilitate social and economic infrastructure have been financed.</p>	<p>1.1.1 FONCODES information system</p> <p>1.2.1 Follow-up and evaluation reports</p> <p>1.3.1 Surveys, follow-up reports and results of the evaluations</p> <p>1.4.1 FONCODES information system</p>	<ul style="list-style-type: none"> <li>The counterpart resources are delivered on time.</li> <li>The technical capacity of FONCODES is maintained.</li> <li>The technical capacity of the municipalities has been improved.</li> </ul>
<p>2. The management capacity of the communities and the institutional capacity of FONCODES has been strengthened.</p>	<p>2.1 By the end of the project, 4,500 communities have been trained in cross-cutting subjects and are able to determine needs and prepare and present projects.</p> <p>2.2 2,785 organizations have been trained to operate and maintain the transferred works by the end of the project.</p>	<p>2.1.1 Lists of participants and consultants' reports</p> <p>2.2.1 List of participants and follow-up and evaluation reports</p>	<ul style="list-style-type: none"> <li>There are sufficient training institutions interested in working in remote rural areas.</li> <li>Resources are allocated in a transparent manner.</li> </ul>

NARRATIVE SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
	2.3 FONCODES' organizational model has been restructured and focuses on management and operations in the zone offices.	2.3.1 Decision approving and placing the new institutional structure in effect	
3. The follow-up and evaluation system is operating.	<p>3.1 Information is broken down and updated (on-line) on the projects financed by FONCODES.</p> <p>3.2 Management or adjustment decisions based on information analysis are made periodically.</p> <p>3.3 External mid-term and final evaluations are made of the program.</p>	<p>3.1.1 Consultants' reports</p> <p>3.2.1 The progress reports presented by FONCODES reflect management decisions based on information analysis.</p> <p>3.3.1 Evaluation report</p>	<ul style="list-style-type: none"> <li>▪ The consulting firm has been contracted in a timely manner.</li> </ul>

**NATIONAL COMPENSATION AND SOCIAL DEVELOPMENT FUND**

**STAGE THREE - FONCODES III (PE-0193)**

**TENTATIVE PROCUREMENT PLAN**

MAIN PROGRAM PROCUREMENTS	VALUE (US\$000)	NUMBER OF PACKAGES	IDB (US\$000)	LOCAL (US\$000)	METHOD	SEMESTER
<b>A. Goods</b>						
Computer equipment and software	1,900	1	1,900		IB	I 2003
<b>B. Technical assistance</b>						
Consulting firm to prequalify training suppliers	50	1	50		PS	II 2002
Contracts with 450 entities (NGOs, universities, consulting firms and individual consultants) to carry out 4,500 projects @ US\$1,500 each	6,750	4,500		6,750	DC	I 2003 to II 2006
Consulting firm for external monitoring	1,100	1	1,100		IB	II 2002
Consulting firm to prepare the baseline	190	1	190		LB	II 2002
Consulting firm for the mid-term evaluation	150	1	150		LB	I 2004
Consulting firm for the final evaluation	700	1	700		IB	II 2005
External auditors	1,200	1	1,200		IB	II 2002
<b>TOTAL</b>	<b>12,040</b>	<b>4,507</b>	<b>5,290</b>	<b>6,750</b>		

**IB** International bidding  
**LB** Local bidding  
**PS** Price shopping  
**DC** Direct contracting